

Gannett's newspapers for the purpose of sharing and distributing general news. For a period of time until 1991 Gannett Broadcasting also had a 17-person Washington Bureau (also called GNS) which on occasion drew upon a story idea from the newspaper side. This broadcast bureau was closed in 1991 because the stations preferred to use Gannett's TV station in Washington (WUSA-TV) as a national source, or to send their own news crews to Washington for major events. In participating in this decision, I am aware that the question of losing some value in coordinating with the newspaper GNS was never even raised. (It should be noted in this respect that the TV stations have many other sources of news from their national networks, CNN (under a group contract), various syndicators, plus other stations in the group, so that the use of GNS was and is unnecessary.)

In my 22 years of employment in the news operations of two of the Nation's leading newspaper-broadcast companies, I have concluded that the opportunities for coalescing functional news and editorial operations of the two media are in fact extremely limited, largely because of the kinds of people these media seek to employ. Good independent-minded journalists, who are always in great demand, reject a centralized form of operation that requires them to hew to some corporate news or editorial line. They rebel against this very idea. Nor would I expect audiences to find such an approach to news operation to be appealing. It is an article of faith at Gannett and other major news companies that effective journalists must be accorded very wide discretion and independent judgment in their pursuit and presentation of news stories. Management must be able to show them that any corporate

limits on this discretion are clearly reasonable and grounded in genuine ethical concerns. In this environment, any efforts to curb journalistic independence to foster some theoretical "company line" would be quickly and vigorously challenged by professional reporters, because they are especially well trained to uncover and challenge policies that have more to do with obtaining conformity than achieving valid goals. Thus, in my view it is not at all surprising that the phenomenon of dictating news positions from some central office is virtually unknown in the modern era of journalism.

It has been noted (Electronic Media, June 8, 1998, p.3) that there has recently been a sharp decline in the number of television stations that broadcast editorials.^{1/} I am familiar with that trend. (Gannett's television stations do not editorialize.) Apart from the obvious fact that this circumstance should serve to further remove any FCC apprehension about the prospect for joint newspaper-broadcast editorial positions, I believe the recent trend is explained by the desire of television licensees to build audience confidence and trust in the objectivity of their news departments. Editorials could suggest to some viewers, no doubt, that the entire station staff may have pre-formed its views and positions on certain issues covered in the news. Again, the pronounced differences in newspaper and electronic journalism traditions, and in the ways these media are perceived by the public, are clearly evident here. (Ironically, in

^{1/} The article reports that less than 10% of top 50 market affiliates may now be editorializing, and the number is declining.

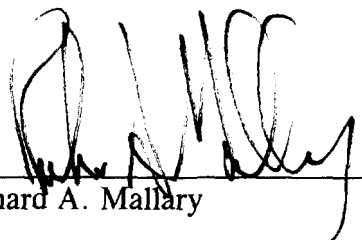
view of the FCC's rule, the EM article states that editorialists hope for more newspaper-TV ownership because of newspapers' "traditional commitments to editorializing.")

Entirely apart from their main lines of business (the ones the FCC rule addresses by its rule barring common control), newspapers and television stations (as well as cable systems) have begun to offer novel forms of joint news outlets for local or regional news delivered via internet websites or cable. Indeed, a few Gannett television stations have working relationships with local and/or nearby non-Gannett newspapers for sharing news resources, and at least one station is working on assisting a local newspaper's website. In my view these new developments usefully illustrate two relevant principles that further undermine the rationale for the FCC's newspaper-broadcast rule: First, given free, unregulated opportunities, news organizations will search for novel, ancillary ways to pool resources and thereby better meet audience needs and desires. This type of creativity should obviously be encouraged. Second, the 1975-era FCC paradigm of assumed newspaper/television station local news dominance is hopelessly ill-suited to an analysis of contemporary free-wheeling media competition.

The fast rise of local website news is probably the most dramatic example of multiplying and novel alternative resources for coverage of local news. But the fact that cable news channels (national, regional and local) are expanding very rapidly also demonstrates that the FCC's theory about a scarcity of electronic news outlets is plainly an anachronism -- television viewers in 1975 did not have CNN, C-Span and the many cable talk programs which

all serve to defuse or destroy the presumed predicate of the rule: that local newspapers and television stations could have a potential monopoly on distribution of news and information, requiring that they be subjected to special ownership limits.

Dated this 17 day of July, 1998.



Richard A. Mallary

Appendix B

An Economic Analysis of the Efficiency Benefits from Newspaper-Broadcast Station Cross-Ownership

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**AN ECONOMIC ANALYSIS OF THE
EFFICIENCY BENEFITS FROM
NEWSPAPER-BROADCAST STATION CROSS-OWNERSHIP**

Prepared For Gannett Company

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I. Introduction

Broadcast stations and newspapers are both engaged in disseminating information. Historically, the information offered by commonly-owned broadcast stations and newspapers has been largely separately produced and conveyed and, as a result, the potential for efficiencies from joint ownership has been largely unexploited. All this is likely to change with the advent of new media like the Internet.

The Internet, which has characteristics of both the electronic and print media, is creating opportunities for cooperation between newspapers and broadcasters, and we are starting to see instances of such cooperation. Although these developments are still in their infancy, they promise substantial benefits to both media owners and consumers of information. However, the scope of these benefits is likely to be limited by the Federal Communications Commission's ban on the formation of new newspaper-broadcast combinations.

The FCC rule that prohibits newspaper-broadcast cross-ownership (except where combinations have been grandfathered) may either prevent the achievement of the benefits of joint operation or force newspapers and broadcasters to engage in potentially less efficient economic arrangements to obtain such benefits. In either case, consumers of information may experience higher prices, less attractive product offerings, or slower innovation than if owners of broadcast stations and newspapers were free to operate under common ownership.

This paper describes the benefits of joint newspaper-broadcast station ownership. In doing so, it draws on the experience of a number of combinations of newspapers and broadcast stations, most involving joint ventures.

Cooperation among these various media is still at an early stage, as indeed are the media themselves, and the synergies among them have not been fully developed. But the operations of these ventures involving newspapers and television stations provide some indication of the types of benefits from new media enterprises that will be lost or impeded if the FCC's ban on newspaper-broadcast station combinations is continued.

II. The Basic Economics of Information Provision

Information has characteristics of what economists call a public good, a good for which the cost of use by an additional consumer is zero.¹ Once a newspaper story, or a television program, or a motion picture, or a novel, or a law review article, or an economics treatise has been created and provided to one user, the additional cost of distributing the same information or entertainment to other users is quite limited. This simple fact explains why producers of information are continually seeking new ways to distribute the same information through different channels. If producers can find additional markets for information that has already been produced, almost all of the additional revenues collected in those markets add to their profits. Consumers benefit from this process because the larger the number of markets from which revenues can be

¹ A pure public good is one for which the amount available to any user is unaffected by the amount taken by other users and from which no user can be excluded once the good has been produced. Information comes close to having the first property.

obtained for the same information, the greater are the incentives to create that information. Consumers may also benefit from greater diversity in the outlets through which information is made available.

There are many examples of the dissemination of the same information through multiple distribution channels. Motion pictures originally produced for domestic theatrical release are licensed to pay-per-view and premium cable program services, sold or leased on videocassettes, carried by the broadcast networks, licensed to individual television stations, and released abroad through the same media. Novels are sold initially in hardcover and subsequently in paperback. Journal publishers receive revenues from subscriptions, the sale of reprints, and license fees for photocopying. Legal research materials originally distributed in print form may also be sold on CD-ROMs or through on-line services.

All of these are examples of the exploitation of a work in the same "form." However, information need not be used in this way. A second type of efficiency may occur when a work created for one medium is modified in some manner and marketed through another medium.² Popular music may be produced for videos as well as for sound recordings. Successful novels may be adapted to motion pictures, live drama, or television series. And, to show that synergies can occur in either direction, successful motion pictures may spawn novels based on their screenplays.

² The subsequent use is sometimes referred to as a "derivative work."

The fact that there may be multiple distribution media for the same information has an important implication. Not only are per-user costs reduced when the same information is reused, but the nature and amount of the information that is produced are also likely to be affected. Whether and how a sound recording is made may depend on its potential exploitation in video form. Whether and how a textbook is produced may depend on the potential for ancillary uses of the same information -- for example, through the sale of CD-ROMs.

A third form of efficiency occurs when the value of one piece of information is enhanced because other types of information are also available, either through the same or a different distribution channel. In some cases, it may be unprofitable to offer some information unless its owner can be assured that other (complementary) information will also be forthcoming. The best way to ensure that the complementary information is available is often for both pieces to be provided by the same entity.

A legal casebook may be more valuable to users, and hence more profitable to offer, if it is linked to treatises on the same or related subjects. An economics textbook may be more valuable if it is sold with separately published study guides. A theatrical musical may be more valuable if its production is accompanied by a sound recording of the score. A motion picture may be more valuable if a novel based on the film is released simultaneously.

In each of these cases, the profits from producing one type of information are enhanced if other information is also available to users. Although

independent suppliers may provide the complementary information, in some circumstances only the creator of the original information may have the incentives to ensure that both of the complements are available to users.

An owner who controls the various forms of distribution of a given piece of information can often more easily coordinate these uses than can separate owners of the different distribution channels.³ In cases where coordination is improved by common ownership, consumers of information are the beneficiaries because they are then likely to receive enhanced information, complementary packages of information, or both.

III. Information Provision and Joint Production by Newspapers and Broadcast Stations

A. The Scope For Efficiencies Is Expanding

There have always been potential efficiency benefits from the joint operation of a newspaper and a broadcast station in the same geographic area. Many of the stories covered by the newspaper will also appear on the station's news reports. Both media report the same local weather and sports results. Both cover the same local elections and social issues. It would seem natural for a joint owner to reduce costs by distributing information collected by the employees of one medium through the other as well. In addition, there would appear to be benefits from developing certain types of information because it could be distributed through more than one medium, and from developing

³ See Section IV below for an explanation of the efficiencies that result when joint production is carried out within a single firm.

information for one medium that is complementary to information developed for the other.

In fact, however, there appears to have been relatively little such activity with respect to newspapers and television stations in the same geographical areas, whether or not they have been jointly owned. It is difficult to determine the precise reasons for the limited ways in which jointly-owned newspapers and television stations have exploited synergies from common ownership. One possibility is the culture clash that can sometimes occur between the two media, in part the result of the contrast between the greater immediacy and visual nature of the information provided through the electronic media and the greater depth of information provided through print. Another is that the potential efficiencies from joint operation were not very great in the past.

This situation appears to be changing. Although some of the changes have involved greater cooperation between newspapers and broadcast stations in their "traditional" roles, the greatest cooperation appears to be occurring in new media, such as the Internet. There are several reasons for this.

First, the "newness" of the Internet may itself contribute to dissolving the cultural barriers between electronic and print journalists. In particular, the Internet can provide a hybrid of newspaper and television services and, if fully exploited, can expand upon the content of the traditional news outlets. The Internet offers news clips with high-quality video streams as well as in-depth daily newspaper stories, and it provides access to a searchable archive of news from multiple broadcast and print sources. The hybrid characteristics of the Internet

preclude both broadcasters and newspaper editors from claiming it as a portion of their traditional domains, and thus each may be less reluctant to participate with the other.

Second, the hybrid nature of the Internet requires skills that neither broadcasters nor print journalists alone possess. The Internet offers the immediacy of broadcasting without the space and time limitations of that medium. Not only does the Internet permit information to be provided in real time, it also allows stories of great length and depth. Indeed, in this regard, it goes even further than newspapers because the information provided can be linked to a vast store of other information, a capability beyond traditional newspapers.

This means that the benefits of cooperation are likely to be greater in the new medium than the benefits of cooperation between traditional newspaper and broadcast operations. In effect, each group may realize that it needs the cooperation and expertise of the other in order to produce information that is attractive to users. Indeed, the ultimate success of an Internet product may involve the blending of material from both print and video sources to produce content that is significantly different from either. Such productions will require reporting, editing, and other journalistic skills that neither medium's professionals currently possess.

Finally, although the cultural barriers between the electronic and print media may be as great as before, the gains from cooperation may now be viewed as greater than before the emergence of the Internet. As a result,

managers may now be demanding cooperation between previously separate activities, cooperation that may only reluctantly be provided.

B. Examples of Television-Newspaper Cooperation

This section describes a number of instances in which companies have combined the resources of newspapers and television operations to offer new media services.⁴ Most of these efforts involve joint ventures rather than common ownership, presumably because of the FCC's ban on the formation of new broadcast station-newspaper combinations.⁵ Although, as discussed in Section IV, such joint ventures may be less efficient than joint ownership, their existence provides evidence of the potential value of newspaper-broadcast station synergies in fostering the development of new media.

The Chicago Tribune and its WGN television and radio stations provide newsgathering resources for ChicagoLand Television News (CLTV), the newspaper's 24-hour cable news channel. The *Tribune* and CLTV share a newsroom that also serves as a studio for CLTV. In addition, *The Chicago Tribune* has cross-promoted and created multimedia joint advertising packages for CLTV, The *Tribune*, WGN-TV, and WGN radio.⁶

The San Jose Mercury News (owned by Knight-Ridder), five dailies owned by Contra Costa Newspapers, and KPIX-TV, a CBS-owned and -operated station in San Francisco, are engaged in a Web site joint venture. The arrangement

⁴ The information in this section was obtained from public reports, unless indicated otherwise. Appendix A presents more detailed information about these developments.

⁵ We also include examples of cable television-newspaper cooperation because the potential for synergies between cable operators and newspapers is similar to that between television broadcasters and newspapers. Note that there is no regulatory prohibition on joint ownership of television stations and newspapers.

⁶ "Tribune Eyeing Miami Regional News Channel," *Multichannel News*, April 10, 1995, p. 16.

involves "a combination of resources designed to enhance all of the media, including the online offerings."⁷ Although KPIX and the newspapers will trade advertising and each will consider the other as the preferred partner for marketing events, the deal is strictly content-driven. According to Jerry Eaton, vice president and general manager of KPIX, "there really aren't revenue aspects to this deal."⁸

Five regional newspapers in Massachusetts, *The Lawrence Eagle Tribune*, *The Patriot Ledger*, *The Middlesex News*, *The Worcester Telegram*, and *The Evening Gazette*, as well as three nearby broadcast stations, WNEV-TV, WFSB-TV, and WLNE-TV, are part of a news association called the New England News Exchange. The New England News Exchange "provides a forum for the exchange of news and information among its members."⁹

The Sun-Sentinel and WPLG-TV have a news-sharing alliance in South Florida. Local news stories from *The Sun-Sentinel* are included five nights a week in WPLG's late newscast, with appearances by the newspaper's journalists. WPLG's three-day weather outlook appears daily in *The Sun-Sentinel*.¹⁰ *The Sun-Sentinel* and WPLG-TV are also partners in a 50-50 joint venture 24-hour cable news and information channel called The South Florida Newschannel. "[P]rint journalists will be consulted and interviewed on the show [South Florida Newschannel]."¹¹

⁷ "San Francisco's Latest Media Convergence," *Editor & Publisher*, April 25, 1998.

⁸ Ibid.

⁹ "Two CBS-Network Affiliated Television Stations Join New England News Exchange," *PR Newswire*, November 15, 1983.

¹⁰ "Sun-Sentinel and WPLG Expand In-Depth News Partnership," *PR Newswire*, March 18, 1996.

¹¹ "Newspapers: More Wired than You May Think, Cable News is Suddenly Hot in Florida," *NewsInc*, October 16, 1995.

The *News & Observer* in Raleigh, NC, and CBS-affiliate WRAL-TV have "teamed up to create ncstormtrack.com, a Web site for weather buffs. It includes stories and a large database of hurricane information from the newspaper along with video, audio and animation of hurricanes from the television station."¹²

The *Lexington Herald-Leader* and WKYT are engaged in the operation of Kentucky Connect, a Web site. They "share news resources and each promotes the Web site."¹³

The *Miami-Herald* and WTVJ, an NBC-owned and -operated station in Miami, have created a partnership for promotion and resource-sharing purposes. The partnership will involve cross-promotional activities, placement of a television camera in the *Miami Herald* newsroom to allow reporters to appear on NBC6 newscasts, expense-sharing on major news stories, conducting joint surveys, and creating an online news product in both English and Spanish.¹⁴

The *Orlando Sentinel* and Time Warner jointly operate Central Florida News 13 (CF13), a 24-hour local news cable channel. "The Sentinel and CF13 will remain separate news-gathering entities, but they will share resources and story leads."¹⁵ The multimedia desk in the Sentinel's newsroom "will coordinate with the news editor at the paper and the assignment desk at the channel and will also be involved with the Sentinel's online news operation."¹⁶ According to John Haile, editor-in-chief of *The Orlando Sentinel*, "We're going to try to

¹² "Online Newspapers as TV Stations; Study Predicts Video will Ultimately be King of the Web," *Editor & Publisher*, September 13, 1997, p. 35.

¹³ Ibid.

¹⁴ "Miami Herald, Local NBC Television Channel Team Up in Unique Partnership," *Miami Herald*, March 1, 1996.

¹⁵ "Orlando/Cable TV: TW, 'Sentinel' Launch News Channel," *MediaWeek*, October 27, 1997.

¹⁶ Ibid.

eliminate duplication of resources – two reporters, one print, one broadcast, covering the same story. We're undergoing a change in what the company is – from a newspaper company to a multi-media corporation with Internet, TV and newspapers.”¹⁷

The Orlando Sentinel and WFTN, the Cox-owned ABC affiliate in Orlando, also have a news-sharing arrangement. “In addition to supplying 20 minutes of news each day to Time Warner's full service network...[S]entinel reporters work on election coverage and daily features with journalists at WFTN.”¹⁸

The Sarasota Herald Tribune and Comcast Cable are partners in a joint venture 24-hour news channel called Sarasota News Now (SNN).¹⁹ SNN's “staff of 30 is integrated into the newsroom of the Herald-Tribune, with the same editors assigning print and broadcast journalists to their stories. Some print journalists will even read news on camera.”²⁰

The Atlanta Journal and Constitution and Prime Cable are engaged in producing a nightly half-hour of news called The Newspaper Channel. Cox, which owns the newspaper, has constructed a “full-scale TV studio” on one of the floors of its newsroom where the cable program is produced. According to Frank Heflin, the paper's Director of Telecommunications, the concept is to “use the resources of the newspaper and select a few stories each day which can be enhanced by video.”²¹

¹⁷ “Time Warner, Tribune Align for 24-hour News,” *MediaWeek*, August 4, 1997, p. 22.

¹⁸ “Surviving TV – It's About Shelf Space,” *Editor & Publisher*, July 6, 1996, p. 5.

¹⁹ “Showdown in Florida,” *Multichannel News*, January 22, 1996, p. 30A.

²⁰ “Newspapers: More Wired than You May Think, Cable News is Suddenly Hot in Florida,” *NewsInc*, October 16, 1995.

²¹ “News Finds Its Niche On Cable,” *Broadcasting*, December 3, 1984, p. 66.

The Gwinnett Daily Post, which is launching a local news and information channel on Cablevision's system, and Northeast Gwinnett Cablevision are engaged in joint marketing efforts. Regular contributors from the print staff will appear on the local channel. The *Daily Post* will provide print advertising space for Cablevision, and will offer a free subscription to *The Gwinnett Daily Post* to each of Cablevision's subscribers.²²

Chronicle Publishing²³ has folded together separate Internet Web pages offered by its daily newspaper, *The San Francisco Chronicle*; its television broadcast station, KRON-TV; and its 24-hour cable news channel, BayTV. The combined operation is known as SFGate, or The Gate. The principal benefits, which are still in the early stages of exploitation, are the ability to share information among, and develop complementary content for, the Web pages of the daily newspaper, television station, and cable television news service that are accessible through this new site. Thus, for example, information collected by the staff of *The San Francisco Chronicle* may appear on The Gate either via the newspaper's Web page or via KRON-TV's Web page, in similar or different form. Similarly, "readers" of the Gate may see material that has been developed originally for use in KRON-TV newscasts. These are examples of the efficiencies described above, whereby information developed for one medium can be used by another because of its public good characteristics.

²² "Ga. System, Local Paper Team Up to Launch News Channel," *Multichannel News*, February 10, 1997, p. 26.

²³ Most of the information in this section was obtained through interviews with employees of Chronicle Publishing or its subsidiaries.

However, The Gate is increasingly becoming more than a simple amalgam of the content of the previously separate SFGate and KRON Online Web sites. Rather, certain stories are being developed simultaneously by *The San Francisco Chronicle* and KRON-TV for use not only by the daily newspaper and the television station but also by The Gate.²⁴ Stories that might not otherwise be covered, or would be covered in a different manner, are having their coverage affected by the fact that they can be exploited by a combined Website. And material from stories appearing in the newspaper and on KRON-TV is appearing on The Gate in wholly different form.

Importantly, these developments are creating a feedback to the operations of the newspaper and television station. The cooperation engendered by the economics of the Internet site is apparently creating synergies not previously exploited between *The San Francisco Chronicle* and KRON-TV. For example, weather information developed for KRON-TV is now also published in the *Chronicle* where in the past the newspaper employed an independent weather service. This illustrates the reduction in costs from using the same information in more than one medium. A second illustration arises where the *Chronicle* and KRON-TV have both developed the same story at the same time. As a result, readers of the newspaper can see live footage and interviews on the television station while KRON-TV viewers can turn to the newspaper for in-depth reporting on the story they have seen on television. Finally, regular meetings in which the

²⁴ This arrangement occasionally takes the form of joint decisions to develop a particular story, but more often it involves each of the outlets informing the other about the stories it is developing so that its partner can develop complementary material if it chooses to do so.

television station and newspaper managers discuss the stories they expect to be covering have become routine, facilitating cooperative and complementary newsgathering that would not otherwise be possible.

IV. The Efficiencies of Joint Ownership

A. Joint Ownership Versus Affiliation

The prior section indicates that some entities are developing new media joint ventures in an attempt to achieve some of the synergies from joint production between newspapers and television stations. Although joint ventures may be the best option available to these entities under the FCC's current ownership rules, they may be inefficient substitutes for common ownership. Joint ventures are less likely to be efficient substitutes for common ownership when there is substantial uncertainty about the value of the venture, as is true for the new media ventures being formed by newspapers and television stations. Given the inherent limitations of joint ventures, we would expect the efficiency benefits from joint production to be higher when firms are allowed to choose whether to develop new media through common ownership or through joint ventures.²⁵

The degree of joint ownership required for firms to achieve efficiencies from joint production is a complex issue that depends on a number of factors. Although it is not possible to definitively answer the question of whether joint ventures are able to realize some or all of the synergies achieved through joint ownership, the economics literature does provide several reasons why joint ventures may be less efficient. This section describes these possible

²⁵ The point is that the firms would choose the most efficient alternative if free to do so.

inefficiencies in the context of the information creation and dissemination businesses conducted by newspapers and television stations.

B. Incentive Problems in Joint Ventures

A joint venture is an arrangement between two or more independent firms to combine resources to produce a product or service. Examples include many of the cooperative arrangements described in Section III.C. A joint venture confronts three classes of issues that can hinder its ability to achieve efficient joint production: (1) the costs of reaching agreement; (2) incentives to withhold private information; and (3) incentives to take actions that are not in the best interests of the joint venture.

First, participants in a joint venture must agree on a common course of action. Even if it is clear that all participants have something to gain from cooperation, they may not all agree on the best course of action. This can lead to delays, or even stalemates, as each participant attempts to influence the venture in a way that it finds more favorable.

More generally, contracts among joint venturers are costly to negotiate and write. Among the questions that must be answered are: How will resources be shared between participants' core businesses and the joint venture? How will costs and revenues be shared? How will disputes be resolved?

When the value of the joint venture is uncertain, which is typically the case with new media, the participants may need to specify conditions for a broad range of contingencies. Moreover, the venturers will typically find it necessary to erect a complex array of safeguards to ensure against opportunistic behavior --

behavior that is beneficial to an individual participant but harmful to the venture as a whole -- and this is costly when the number of contingencies and the scope for opportunism are large.²⁶

A second problem faced by the joint venture arises when the participants have private information about the value of their own productive inputs into the venture, or the value of the jointly produced product. For example, a newspaper that offers news and advertising service on its own Web page likely has better information about the benefits and costs of an online information service than a television station that uses its Web page strictly to promote its television station. Similarly, the television station likely has a better understanding of the costs of creating video content than does the newspaper. In this situation, the newspaper has an incentive to understate the value of combining video and print on the Web page in an attempt to obtain a greater share of the profits, and the television station has an incentive to over-represent the cost of supplying the video content for similar reasons.

The incentive for joint venture participants to misrepresent private information is well known from the economics literature on agency relationships

²⁶ Oliver Williamson describes three types of safeguards commonly employed in complex contracts. First, the parties may specify a penalty and/or "severance" payment for premature termination of the venture. Second, the parties may specify a governance structure for resolving disputes. Third, the parties may specify "trading regularities" that support and signal their intentions, such as reciprocity requirements. See O.E. Williamson, *The Economic Institutions of Capitalism*, The Free Press, 1985, p. 34.

and bargaining under incomplete information.²⁷ As that literature indicates, misrepresentation is not without risk, because it may lead to the perception that there are no gains from trade when potential benefits do exist. However, each individual venturer prefers to take this risk in order to increase its chances of capturing a larger share of the benefits from joint operation. In the worst case, misrepresentation results in failure to reach any agreement at all.²⁸ In less extreme cases, misrepresentation results in an alliance with a more limited scope than efficiency would dictate.²⁹

The third general problem faced by a joint venture is how to align the incentives of each participant with the best interests of the joint venture. The easiest way to see this problem is with a simple example. Suppose that a newspaper and television station form a joint venture to create a Web page that will offer integrated print and video information online supported by advertising revenues. The venture operates as a profit center, paying each partner the cost of the content it provides and distributing half of the advertising profits to each

²⁷ In the language of this literature, each firm requires "information rents" for it to be willing to reveal its private information. The problem then arises that the information rents may be larger than the potential gains from trade, in which case the potential gains are left unexploited. A useful introduction to the literature on exchange under incomplete information is contained in P. Milgrom and J. Roberts, *Economics, Organization, and Management*, Prentice Hall, 1992; see especially Chapter 5.

²⁸ An example of the difficulty may be the Knight-Ridder experience with *The San Jose Mercury News*, where we understand that negotiations extended over a long period of time before an agreement was finally reached with KPIX earlier this year.

²⁹ For example, we understand that the Knight-Ridder alliance is focused primarily on cross-promotion without significant integration of content.

partner.³⁰ Under this type of arrangement, are each partner's incentives aligned with the joint venture? That is, will each partner take actions that maximize the profits of the venture?

The answer is likely to be no, for reasons that are well known in the economics literature. The general problem is this: If one partner "shirks" -- e.g., by purchasing lower-quality equipment, assigning its best people to other projects, or simply substituting leisure for work -- it receives all the benefits of shirking but bears only half the cost.³¹ Thus, unless the joint venture contract specifies all of the costly decisions that each participant makes on an ongoing basis in providing inputs to the joint venture, and thereby prevents such shirking, each participant will have an incentive to under-provide quality or other productive inputs to the venture.³²

The shirking problem exists even when the venturers' core businesses are unrelated to the business of the joint venture, so long as each of the participants receives a smaller share of the profits of the joint venture than the gains it receives by shirking. However, the problem is likely to be even worse when the core businesses provide services that compete either for resources or in the

³⁰ The assumed 50-50 division of profits is arbitrary. Any division of the profits would allow us to make the points that follow.

³¹ The meaning of "shirk" in this context is synonymous with "moral hazard" as that term is used in the economics literature. Moral hazard refers to post-contractual opportunism that arises when actions that have efficiency consequences cannot be specified in a contract so that the person taking them can choose to pursue his own private interests.

³² A *complete contract* would specify each partner's input requirements for every possible contingency and, if enforceable, would eliminate the shirking problem. The shirking problem arises because it would be prohibitively costly to specify and enforce a complete contract, so that contracts are typically *incomplete*.

output market with the joint venture. For example, the television station partner may spend the bulk of its production time on its television operations even after its Web page joint venture develops substantial advertising revenues because Web page. The participants may also be reluctant to cannibalize their advertising revenues in their core businesses, leading them to shirk on quality and misrepresent their costs (and/or benefits) or both to the joint venture.

The inefficiencies of joint ventures that arise from incentives to shirk are exacerbated when the benefits of the venture are highly uncertain and one or more of the participants in the venture is risk-averse.³³ Under these circumstances, the design of the joint venture contract is complicated by the participants' desire for insurance along with their goal to minimize shirking. For example, suppose that the newspaper owner is risk-averse. Providing insurance to the owner of the newspaper requires that the television station receive most of the gains and bear most of the losses of the joint venture. However, a contract that gives most of the gains and losses to the television station provides little incentive for the newspaper to focus productive effort on the joint venture.

By describing the difficulties involved in forming successful joint ventures, we do not mean to suggest that alliances between newspapers and television stations do not provide benefits for consumers.³⁴ Numerous such alliances already exist, as described above. Our point is that joint ventures face difficult

³³ An example of a "risk-averse" individual is one who prefers to receive \$100 with complete certainty rather than \$50 or \$150 with equal likelihood.

³⁴ There are mechanisms that help resolve some of the incentive problems raised by divergent interests and incomplete information among joint venture partners. For example, a firm may increase the effort devoted to the joint venture in order to develop a reputation as a reliable partner and thereby keep a profitable venture from dissolving.